

Internal Revenue Service

Number: **202035003**

Release Date: 8/28/2020

Index Number: 860B.00-00

Department of the Treasury

Washington, DC 20224

[Third Party Communication:

Date of Communication: Month DD, YYYY]

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:FIP:B02

PLR-121234-19

Date:

March 11, 2020

Legend

Trustee =

Investor
Plaintiffs =

Court 1 =

Court 2 =

Action 1 =

Action 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

State A =

X =

Dear :

This letter is in reply to your letter dated September 6, 2019, in which Trustee, solely in its capacity as trustee or indenture trustee of real estate mortgage investment conduits ("REMICs") identified in Appendix A (each a "Taxpayer," and together, the "Taxpayers"), requests certain rulings in connection with sections 860A through 860G of the Internal Revenue Code with respect to the Settlement Agreement described below. Specifically, you request that in the case of each Taxpayer for which a timely, valid and continuing REMIC election has been made, the execution of the Settlement Agreement and the distribution of the Settlement Amount in accordance with the Settlement Agreement and the Plan of Allocation described below:

1. is a direct payment between Trustee and the Investor Plaintiffs and will not result in a deemed payment to or made by a Taxpayer for federal income tax purposes;
2. will not be treated as a "prohibited transaction" within the meaning of section 860F(a)(2) or as a contribution that is subject to the tax imposed under section 860G(d)(1); and
3. will not be treated as an asset of a Taxpayer within the meaning of section 860D(a)(4).

FACTS

Background

Each Taxpayer has elected to be treated as a REMIC within the meaning of section 860D and is evidenced by separate Pooling and Servicing Agreements or Indentures and related Sales and Servicing Agreements (each a "Governing Agreement" and collectively, the "Governing Agreements"). Under the Governing Agreements, Trustee serves as trustee or indenture trustee for each of the Taxpayers. The law of State A governs the rights and obligations of the parties under the Governing Agreements, including the Trustee. The annual accounting period for each Taxpayer is the calendar year and each Taxpayer utilizes the accrual method of accounting for maintaining its accounting books and filing its federal income tax return.

The securitization process for each Taxpayer generally occurred as follows:

1. Various entities sold residential mortgage loans (the “Mortgage Loans”) to securitization vehicles formed under state law with respect to the Taxpayers.
2. For Taxpayers governed by Pooling and Servicing Agreements, Mortgage Loans were conveyed to Trustee, as trustee, to be held in trust for the benefit of certificate holders. For Taxpayers governed by Indentures and Sale and Servicing Agreements, the Mortgage Loans were conveyed to the Taxpayers, for the benefit of noteholders, and the Taxpayers granted Trustee, in its capacity as indenture trustee, all of their right, title, and interest in the Mortgage Loans.
3. Several classes of certificates or notes representing various entitlements to the underlying mortgage pool’s cash flows then were issued and sold to investors, including the Investor Plaintiffs, representing regular interests issued by Taxpayers for federal income tax purposes.
4. Trustee and various servicers were charged with responsibility for, among other things, collecting debt service payments on the Mortgage Loans and remitting payments on a monthly basis to the Trustee for distribution to the investors.

The Governing Agreements for each Taxpayer contain a series of representations and warranties made by the sellers of the Mortgage Loans for the benefit of the Taxpayers. In general, as specified in each agreement, these can include representations that the Mortgage Loans were underwritten in all material respects in accordance with certain underwriting guidelines, that the Mortgage Loans conform in all material respects to their descriptions in the investor disclosure documents, that the origination, underwriting and collection practices of the seller and persons acting on behalf of the sellers have been legal, prudent and customary in the mortgage lending and servicing business, and that the Mortgage Loans were originated in accordance with all applicable laws. The Governing Agreements also impose servicing obligations that require the Mortgage Loans be serviced and administered in accordance with the terms of the Governing Agreements and customary and usual standards of prudent mortgage loan servicers.

The Dispute

On Date 1, Investor Plaintiffs that at the time were current regular interest holders in Taxpayers filed a complaint as a putative class action against Trustee in Court 1

(“Action 1”) relating to certain regular interests issued by the Taxpayers. Action 1 alleged claims for breach of contract, breach of fiduciary duty, and violations of the Trust Indenture Act of 1939, claiming that Trustee breached duties owed under contract and the common law to the Taxpayers and investors by failing to (i) notify deal parties of and enforce repurchase claims upon discovery of alleged breaches of representations and warranties with respect to Mortgage Loans that are assets of Taxpayers, and (ii) provide notice to servicers of alleged known servicing violations with respect to such Mortgage Loans.

On Date 2, Court 1 issued a decision and order declining to exercise supplemental jurisdiction over the Investor Plaintiffs’ state law claims and granted the Investor Plaintiffs leave to file an amended complaint in Action 1. The Investor Plaintiffs filed an amended complaint with Court 1 on Date 3 (“Amended Action 1”). In Amended Action 1, Investor Plaintiffs asserted only direct causes of action against the Trustee made on behalf of the investors as a class. Consistent with State A law, in Amended Action 1, the Investor Plaintiffs did not assert any derivative causes of action against the Trustee made on behalf of the Taxpayers.

On Date 4, the Investor Plaintiffs also filed a complaint against Trustee in Court 2 (“Action 2”) relating to certain regular interests issued by the Taxpayers. Action 2 contains claims substantially similar to Amended Action 1. Specifically, Action 2 asserted claims against Trustee for breach of contract, breach of fiduciary duty, breach of the duty to avoid conflicts of interest, and negligence. Like Amended Action 1, Action 2 was also brought as a putative class action of direct causes of action against Trustee by the Investor Plaintiffs and did not assert derivative actions on behalf of the Taxpayers.

On Date 5, the Investor Plaintiffs consolidated and amended Amended Action 1 and Action 2 and filed one putative class action complaint in Court 2. Consistent with State A law, the amended Action 2 (“Amended Action 2”) asserted only direct causes of action against Trustee and did not include any derivative actions made on behalf of Taxpayers. The Amended Action 2 alleged that Trustee’s conduct directly caused losses to Investor Plaintiffs.

The Settlement Agreement

The Investor Plaintiffs and Trustee settled the actions on a class-wide basis pursuant to a Stipulation and Agreement of Settlement dated as of Date 5 (the “Settlement Agreement”). On Date 6, following notice and a settlement fairness hearing, Court 2 approved the Settlement Agreement. Court 2 also approved a settlement amount and a plan to allocate that amount, as described below.

By its terms, the Settlement Agreement is applicable to any person or entity (including both current and former holders of regular interests in Taxpayers) who held or acquired regular interests in Taxpayers on or after Date 7. Not all current and former

holders of regular interests in Taxpayers will recover a portion of the Settlement Amount (defined below) under the Settlement Agreement. To be entitled to a recovery, each participating regular interest holder is required to be an eligible class member (i.e., an investor who held or holds regular interests in Taxpayers at any time between Date 7 and Date 6) who does not request exclusion from the class and who submits a valid proof of claim form.

Pursuant to the Settlement Agreement, Trustee paid X (the “Settlement Amount”) to an escrow account for distribution to the applicable eligible class members. No portion of the Settlement Amount will be taken or reimbursed from any funds of Taxpayers. In addition, no portion of the Settlement Amount will be paid to Taxpayers, and no amount will be reflected on Taxpayers’ books and records or accounted for by any Taxpayer.

Eligible class members can recover a portion of the Settlement Amount. The distribution of the Settlement Amount will be made pursuant to a “Plan of Allocation” that was approved by Court 2 on Date 6. The Plan of Allocation for distribution of the Settlement Amount is based on the estimated diminution in value of plaintiffs’ regular interests allegedly caused by Trustee’s conduct. Payments under the Plan of Allocation will not be made pursuant to the Taxpayers’ Governing Agreements. This is, in part, because class members had a due process right (which some exercised) to request exclusion from the settlement, and the distributions will, accordingly, vary from existing waterfall provisions in the Taxpayers’ Governing Agreements. Moreover, former regular interest holders, who are not entitled to any current benefit under these waterfall provisions, will also recover a portion of the Settlement Amount.

LAW AND ANALYSIS

Section 860D defines a “real estate mortgage investment conduit” as any entity that, among other things: (1) has made an election to be treated as a REMIC for the current taxable year and all prior taxable years; (2) all of the REMIC’s interests are residual interests or regular interests; (3) the REMIC only has one class of residual interest; and (4) substantially all of the REMIC’s assets consists of qualified mortgages and permitted investments.

Section 1.860D-1(b)(3)(i) provides that for purposes of the asset test of section 860D(a)(4), substantially all of a qualified entity’s assets are qualified mortgages and permitted investments if the qualified entity owns no more than a de minimis amount of other assets. Section 1.860D-1(b)(3)(ii) provides that the amount of assets other than qualified mortgages and permitted investments is de minimis if the aggregate of the adjusted bases of those assets is less than one percent of the aggregate of the adjusted bases of all of the REMIC’s assets.

Section 860G(a)(1) defines a “regular interest” in a REMIC as any interest in a REMIC which is issued on the startup day with fixed terms and which is designated as a

regular interest if (A) such interest unconditionally entitles the holder to receive a specified principal amount (or other similar amount), and (B) interest payments (or other similar amount), if any, with respect to such interest at or before maturity (i) are payable based on a fixed rate (or to the extent provided in regulations, at a variable rate), or (ii) consists of a specified portion of the interest payments on qualified mortgages and such portion does not vary during the period such interest is outstanding.

Section 860G(a)(5) defines “permitted investments” as any cash flow investment, qualified reserve asset, or foreclosure property. “Cash flow investment” is any investment of amounts received under qualified mortgages for a temporary period before distribution to holders of interests in the REMIC. Section 860G(a)(6).

Section 1.860G-2(g)(1)(ii) states that, in determining what constitutes a cash flow investment the term “payments received on qualified mortgages” includes (i) payments of interest and principal on qualified mortgages, including prepayments of principal and payments under credit enhancement contracts; (ii) proceeds from the disposition of qualified mortgages; (iii) cash flows from foreclosure property and proceeds from the disposition of such property; (iv) a payment by a sponsor or prior owner *in lieu of* its repurchase of a defective obligation; and (v) prepayment penalties required to be paid under the terms of a qualified mortgage when the mortgagor prepays the obligation.

Section 1.860G-2(f)(1) defines a defective obligation as a mortgage subject to certain defects including that the mortgage does not conform to a customary representation or warranty given by the sponsor or prior owner of the mortgage regarding the characteristics of the mortgage, or the characteristics of the pool of mortgages of which the mortgage is a part.

Section 860G(a)(9) defines the term “startup day” as the day on which the REMIC issues all of its regular and residual interests.

Except as provided in Section 860G(d)(2), section 860G(d)(1) imposes on any amount that is contributed to a REMIC after the startup day a tax on 100 percent of the amount contributed. Section 860G(d)(2) provides that the tax on contributions after the startup date shall not apply to any contribution which is made in cash and is either (A) any contribution to facilitate a cleanup call (as defined in regulations) or a qualified liquidation, (B) any payment in the nature of a guarantee, (C) any contribution during the 3-month period beginning on the startup day, (D) any contribution to a qualified reserve fund by any holder of a residual interest in the REMIC, or (E) any other contribution permitted in regulations.

Section 1.860D-1(b)(2)(i) provides that the right to receive from the REMIC payments that represent reasonable compensation for services provided to the REMIC in the ordinary course of its operation is not an interest in the REMIC. Payments made by the REMIC in exchange for services may be expressed as a specified percentage of interest payments due on qualified mortgages or as a specified percentage of earnings

from permitted investments. For example, a mortgage servicer's right to receive reasonable compensation for servicing the mortgages owned by the REMIC is not an interest in the REMIC.

Section 860F(a)(1) imposes a tax equal to 100 percent of the net income derived from prohibited transactions. Section 860F(a)(2) defines prohibited transaction to mean one of the following: (A) disposition of any qualified mortgage transferred to the REMIC other than a disposition pursuant to (i) the substitution of a qualified replacement mortgage for a qualified mortgage (or the repurchase in lieu of substitution of a defective obligation), (ii) a disposition incident to the foreclosure, default, or imminent default of the mortgage, (iii) the bankruptcy or insolvency of the REMIC, or (iv) a qualified liquidation, (B) the receipt of any income attributable to any asset which is neither a qualified mortgage nor a permitted investment, (C) the receipt by the REMIC of any amount representing a fee or other compensation for services, or (D) gain from the disposition of any cash flow investment other than pursuant to any qualified liquidation.

If the Settlement Amount was treated as a deemed payment to or made by Taxpayers, then the Settlement Amount could raise a number of issues under the REMIC rules described above, including REMIC qualification issues under section 860D and whether the Settlement Amount would be subject to the taxes under sections 860F(a)(1) and 860G(d)(1). For the reasons set forth below, it is appropriate to treat the Settlement Amount as a payment between the Trustee and Investor Plaintiffs.

The Settlement Agreement resolves direct causes of action asserted in Amended Action 2. Consistent with State A law, the Investor Plaintiffs did not assert any derivative actions on behalf of Taxpayers in Amended Action 2 and the Settlement Agreement does not resolve any such actions. Further, the distribution of the Settlement Amount is consistent with its treatment as a settlement of direct claims between the Trustee and investors because: (i) Trustee paid the Settlement Amount into an escrow account for direct distribution to Investor Plaintiffs who are eligible class members; (ii) no portion of such Settlement Amount was, or will be, taken from, or reimbursed from, the assets of any Taxpayer; and (iii) no portion of the Settlement Amount will be paid to or through Taxpayers. Settlement Amounts will not be paid to all regular interest holders who would recover pursuant to Taxpayers' payment waterfall provisions. Instead, current and former regular interest holders must be eligible class members, not opt out from the settlement, and submit timely and valid proofs of claims to receive their portion of the Settlement Amount. Finally, former regular interest holders who are eligible class members, and who are not entitled to any current benefit under the waterfall provisions of Taxpayers, may nevertheless recover their portion of the Settlement Amount. As a result, the Settlement Amount is a direct payment between Trustee and the Investor Plaintiffs for federal income tax purposes, is not a deemed payment received or made by the Taxpayers under sections 860A through 860G and is not an asset of the Taxpayers.

CONCLUSION

For the reasons set out above, we hereby rule that in the case of each Taxpayer for which a timely, valid and continuing REMIC election has been made, the execution of the Settlement Agreement, and the distribution of the Settlement Amount in accordance with the Settlement Agreement and the Plan of Allocation as approved by Court 2:

1. is a direct payment between Trustee and the Investor Plaintiffs and will not result in a deemed payment to or made by a Taxpayer for federal income tax purposes;
2. will not be treated as a “prohibited transaction” within the meaning of section 860F(a)(2) or as a contribution that is subject to the tax imposed under section 860G(d)(1); and
3. will not be treated as an asset of a Taxpayer within the meaning of section 860D(a)(4).

CAVEATS

This ruling’s application is limited to the facts, representations, Code sections, and regulations cited herein. Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences related to the facts herein under any other provisions of the Code. In particular, no opinion is expressed or implied regarding any federal income tax consequences that may pertain to the Investor Plaintiffs, or as regards any other federal income tax consequences that may pertain to Trustee or Taxpayers.

This ruling is directed only to the Taxpayers that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by Trustee and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

In accordance with the provisions of a Power of Attorney on file, we are sending a copy of this ruling letter to your authorized representatives.

Sincerely,

John W. Rogers III
Senior Technician Reviewer, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)